Regional Economic Report
July – September 2018
Summary

During the third quarter of 2018, economic activity in Mexico expanded, after having contracted in April – June. Specifically, manufacturing exports grew at a higher rate vis-à-vis the loss of dynamism exhibited during the second quarter, while private consumption remained on a positive trend. In contrast, investment is anticipated to have contracted once more during the quarter. As regards production, the positive trend maintained by services and the recovery of the secondary activities stand out, as compared to the weakness registered in the previous quarter. Within industrial production, manufacturing remained on an upward trajectory, growing at a rate even higher by the end of the period. In contrast, both construction and the mining, quarrying, and oil and gas extraction sector remained on a negative trend. Similarly, after having fallen considerably during the second quarter, the primary activities registered a quarterly growth.

During the reported quarter, economic activity in Mexico expanded across all regional economies. Indeed, the North-Central and Southern regions are estimated to have displayed a rebound, following the contraction in the previous quarter, while the Northern and the Central regions grew at a slightly faster rate. This performance is largely attributed to the positive trajectory of the services subsector; to the widespread growth of the manufacturing industry, particularly more notable in the export-oriented regions; to the better performance of retail trade, and of agricultural production in the Central and Southern regions; to the rebound in construction in the Southern and Northern regions; and, to the expansion of tourism in the Central region.

During the period analyzed in this Report, annual headline inflation increased from an average of 4.57% to 4.91% between the second and the third quarters of 2018. This evolution partly resulted from the upward path followed by non-core inflation until September, which mirrored the higher energy prices, mainly of gasoline and LP gas. Indeed, between the second and third quarters of 2018, annual non-core inflation rose from 7.28 to 8.78%. On the other hand, despite a certain loosening of slack conditions in the economy with respect to the beginning of the year, annual core inflation showed a resistance to decline during the third quarter of 2018. This was partly due to the indirect effects of higher energy prices on the production costs of some of their components. Other factors also contributed to the persistence of core inflation and to the growing trend in the annual growth rates of the price subindex of services other than education and housing. Among them are the evolution of the exchange rate, the absence of slack and the development of real wages. In this way, core inflation stopped declining and remained practically constant at levels above the target. In particular, annual core inflation declined from 3.67 to 3.64% during the reference quarters.

In October and November, annual headline inflation decreased to a level of 4.72%. This is largely attributed to the decline in annual non-core inflation, which registered 8.07% in November. These results were due to the recent reductions in LP gas prices, and the lower price increments of gasoline and electricity fares, as compared to the same period of last year. As for annual core inflation, it reached 3.63%.

The evolution of national headline inflation spread throughout all regional economies. In particular, both the direct and indirect effects of the higher energy prices and the upward trend of the annual growth rate of the price subindex of services other than education and housing were reflected in higher inflation levels across the four regions of Mexico. However, in October and November, annual headline inflation fell in all regions, due to a decline in non-core inflation, particularly in the item of energy prices. It is noteworthy that the Central region continued to exhibit the highest levels of inflation, which is mostly accounted for by the higher growth rates of energy prices in that region, especially

electricity fares, and services prices, given that due to demand-related factors, the prices of housing, education and other services in that region post higher growth rates than in other regions.

Business agents consulted in the four regions expect the demand for their own goods and services to grow during the following twelve months. In the same vein, they anticipate an increase in the number of hired personnel and in physical capital. It should be noted that in most regions the referred signals were more intense than in the previous quarter.

The interviewed business agents listed the following risks to regional economic growth. Among those to the downside, they signaled: i) that public safety deteriorates; ii) that uncertainty persists concerning the public policies to be implemented by the incoming administration; and iii) that the referred policies lead to a deterioration of public finances, and therefore to an environment of greater uncertainty, which in turn could lower investment levels. In contrast, among the risks to the upside, they noted the following: i) that the new trade agreement with the U.S. and Canada contributes to revive investment; and ii) that greater-than-expected levels of investment are observed, particularly in public infrastructure.

With regard to the expected development of prices for the following twelve months, most interviewed business agents anticipate the sales prices of their own goods and services to grow at an annual rate lower or equal to that observed during the previous year, although the share of business agents that have favorable expectations slightly decreased with respect to the previous quarter. In line with the above, more than half of the interviewed contacts expect input prices and labor costs to increase at a rate similar or below that exhibited over the previous twelve months.

To complement the analysis of the regional economic activity published in this Report, several analytical boxes are included. Box 1 estimates both direct and indirect effects of the fall in crude oil production on economic activity in the Gulf of Mexico during the period 2013-2018. Box 2 analyzes the probability of different occupations becoming automated in different regional economies, and its relation with the level of education. Finally, Box 3 estimates a multidimensional infrastructure index for the regions of Mexico, and describes its relationship with some variables that are related with economic development.

Looking forward, the regional economies are expected to continue facing a complex environment characterized by important risks, both in the domestic and the external fronts, which, if they materialize, could affect its potential growth in the medium and long terms. Hence, in addition to strengthening the macroeconomic framework, it is key to adopt the measures conducive to greater productivity and that would generate an environment of confidence and certainty for investment, at the same time reinforcing the transparency and accountability of public policies at all levels of government.